

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

June 28, 2002

IN RE:

**GENERIC DOCKET ADDRESSING
RURAL UNIVERSAL SERVICE**

)
)
)
)
)

DOCKET NO. 00-00523

INITIAL ORDER OF HEARING OFFICER

**FOR THE PURPOSE OF ADDRESSING LEGAL ISSUES 2 & 3 IDENTIFIED IN THE
REPORT AND RECOMMENDATION OF PRE-HEARING OFFICER FILED ON
NOVEMBER 8, 2000**

This matter is before the Tennessee Regulatory Authority ("TRA" or "Authority") upon the action of the Hearing Officer, Director Melvin J. Malone,¹ wherein the Hearing Officer requested the parties in this matter to submit legal briefs, *inter alia*, on the three following issues:

1. Does the TRA have jurisdiction over the toll settlement agreements between BellSouth and the Rural Local Exchange Carriers?
2. Should the withdrawal of toll settlement agreements between BellSouth and the Rural Local Exchange Carriers be considered in the Rural Universal Service proceeding?
3. Is the State's Universal Service statute, as enacted, intended to apply to rate of return regulated companies, as such companies are defined under state law?

¹ See Order Opening Docket For Purpose Of Addressing Rural Universal Service And Appointing Hearing Officer, TRA Docket No. 00-00523 (July 14, 2000).

I. BACKGROUND

The Hearing Officer issued an Initial Order, on December 29, 2000, addressing Legal Issue No. 1 in which it was concluded that the Authority does have jurisdiction over the toll settlement arrangements between BellSouth and the Rural Local Exchange Carriers.² Remaining are decisions with respect to Legal Issues No. 2 and No. 3. After careful consideration, the Hearing Officer concludes, as a matter of law, that: (1) the withdrawal of toll settlement agreements between BellSouth and the Rural Local Exchange Carriers should be considered in the Rural Universal Service Proceeding; and, (2) the State's Universal Service statute, as enacted, is intended to apply to rate of return regulated companies, as such companies are defined under state law.

II. ANALYSIS OF LEGAL ISSUES

a. Legal Issue No. 2:

Should the withdrawal of toll settlement agreements between BellSouth and the Rural Local Exchange Carriers be considered in the Rural Universal Service proceeding?

As a preliminary matter, it is noted that the Tennessee General Assembly has declared that "universal service shall be maintained; and rates charged to residential customers for essential telecommunications services shall remain affordable."³ This legislative proclamation is not discretionary but directive; and, imposes a concrete, continuous, and binding duty upon the

² "As a matter of law, the TRA's jurisdiction and authority over the toll settlement arrangement memorialized within the toll settlement agreements remains intact." *Initial Order of Hearing Officer*, TRA Docket No. 00-00523, p. 10 (Dec. 29, 2000).

³ Tenn. Code Ann. § 65-4-123.

Authority to ensure that universal service and affordability of rates for essential services are maintained.⁴ This legislative decree is the basic, unambiguous, and straight-forward lawful direction that drives the result reached herein; and, is, indeed, the primary regulatory fiat on which this decision is based.⁵ It is also necessary to note that the basic identity of this issue, as purely a question of law, makes it needless, at this time, to formulate or speculate on a prototype of a specific universal service operational or administrative model as a prerequisite to resolving this question. In fact, attempts to devise or conceive a model, at this juncture, would likely confuse an otherwise lucid, purely legal question, absent the benefit of an evidentiary record that, at a minimum, identifies specific or general universal service needs that accomplish the ultimate goal of maintaining rates for essential telecommunications services at affordable levels.

⁴ While the legislature left it to the Authority to define “essential telecommunications services,” the Tennessee Court of Appeals has recently provided some guidance as to what services, at a minimum, should be included within the definition of essential telecommunications services. In *United Telephone-Southeast, Inc., v. Tennessee Regulatory Authority*, 2001 WL 266051 (Tenn.Ct.App.) at *3, the Court opined:

The final two provisions establish the guiding principles applicable to our analysis: that universal service be maintained and that residential rates for essential services remain affordable. We interpret the limitations on rate increases for basic services as fulfilling the goal of maintaining affordable rates for residential essential services. Thus we conclude that **the legislature intended that “basic” services have some correlation to “essential” services.** (emphasis added).

We also interpret the legislature’s declaration of state telecommunications policy as reflecting a relationship between universal service and basic services. In addition, the General Assembly has specifically related the two concepts:

Universal service, consisting of residential basic local exchange telephone service at affordable rates and carrier-of-last-resort obligations must be maintained after the local telecommunications markets are opened to competition. In order to ensure the availability of affordable residential basic local exchange telephone service, the authority shall formulate policies, promulgate rules and issue orders which require all telecommunications service providers to contribute to the support of universal service. Tenn. Code Ann. § 65-5-207(a).

Accordingly, it is reasonable to adopt, for the purposes of this analysis, a definition of essential services that includes, at a minimum, the definition of basic local exchange telephone services articulated in Tenn. Code Ann. § 65-5-208(a)(1). It is apparent, however, that the General Assembly mandated that universal service be maintained under competition and under varying forms of regulation, while providing the Authority the flexibility to identify what services should be considered essential telecommunications services.

⁵ The Hearing Officer is well aware that the resolution of universal service issues must be achieved in harmony with 47 U.S.C. § 254(f) and Tenn. Code Ann. § 65-5-207.

Consequently, the single question to be answered here is whether, as a matter of law, the withdrawal of the toll settlement agreements should be considered in this proceeding.

As a general proposition, it is virtually undisputed that rural serving areas tend to be low-density service areas where the cost of providing telephone service is higher than in more populated urban areas. As a consequence of rural carriers incurring higher costs, rates for residential local service in these areas likely would exceed those of their urban counterparts in the absence of implicit or explicit subsidies. It is apparent that actions that result in upward influence on residential rates of rural providers potentially jeopardize the affordability of residential local services. In an effort to establish and maintain residential local service rates at affordable levels, rural carriers have historically priced business and discretionary service rates high relative to their costs and priced residential service low, perhaps even below cost.

Additionally, in an effort to assist rural carriers in earning their rate of return, the Tennessee Public Service Commission directed BellSouth Telecommunications, Inc. ("BellSouth") to enter into toll settlement arrangements that were structured in a manner that enabled independent carriers to maintain their current revenue streams. While these arrangements were not ordered specifically as a form of universal service subsidy, there is little doubt that the rural carriers' ability to meet universal service obligations and to maintain the affordability of residential local service is dependent upon their ability to earn a fair rate of return. Given the very strong connection between the contribution that the toll settlement arrangements provide to rural carriers and their ability to maintain affordable residential services, it is lawfully incumbent upon the Authority to consider the withdrawal of toll settlement agreements between BellSouth and the Rural Local Exchange Carriers in the Rural Universal Service Proceeding.

The decision here to consider toll settlement agreements, as a matter of law, in the Rural Universal Service Proceeding, stands distinct and apart from a judgment, not reached or considered herein, that toll settlement agreements will, or should, become a component of rural universal service support.

b. Legal Issue No. 3:

Is the State's Universal Service Statute, as enacted, intended to apply to rate of return regulated rural companies, as such companies are defined under state law?

Tennessee law, as embodied in the 1995 Tennessee Telecommunications Act (the "1995 Act"), does not specifically or implicitly exclude rate-of-return regulated companies from the declaration of telecommunications services policy in Tenn. Code Ann. § 65-4-123⁶ or the universal service provisions of § 65-5-207. There is, however, ample support in the 1995 Act that firmly supports the conclusion that the General Assembly ensured the inclusion of rate-of-return regulated companies in the provisions of Tenn. Code Ann. §§ 65-4-123 and 65-5-207.

Tennessee's Universal Service statute, Tenn. Code Ann. § 65-5-207(a), provides that universal service "must be maintained." It is evident from this language that the focus of this section is on universal service as it was traditionally understood prior to the enactment of the 1995 Act which, it is not contested, included the provision of affordable basic service in high-cost areas that are typically rural areas. Under the market-opening provisions of the 1995 Act, rural carriers are the very providers that are most likely to remain under rate-of-return regulation.⁷ Moreover, should the Authority determine that an alternative, as opposed to the traditional, universal service support mechanism is warranted, § 65-5-207 requires it to

⁶ Tenn. Code Ann. § 65-4-123 provides in part that "universal service shall be *maintained*." (emphasis added).

“[c]onsider provision of universal service by incumbent local exchange companies” and to “[c]onsider . . . [t]he amount by which the embedded cost of providing residential basic local exchange telephone service exceeds the revenue received from the service, including the cost of the carrier-of-last-resort obligations, for both high- and low-density service areas.”⁸ It is reasonable to conclude that “incumbent local exchange companies” include all carriers regardless of their current form of regulation and to equate “low-density service areas” with rural areas. Accordingly, there exists legal continuity in holding that Tenn. Code Ann. § 65-5-207 includes rate-of-return regulated rural carriers within its provisions.⁹

Consistent with a legal determination that the form of universal service support mandated by the 1995 Act is inclusive of rural carriers is the inevitable companion holding that rate-of-return regulation in a competitive environment is compatible with the universal service provisions of the 1995 Act. Although questions may arise from the potential overlap of a carrier’s right to achieve a set rate of return and its potential right to subsidies to support universal service,¹⁰ the existence of such an overlap is an insufficient basis to support a conclusion that the General Assembly intended to exclude rate-of-return regulated carriers from participation in a universal service support mechanism.

⁷ See, e.g., Tenn. Code Ann. § 65-4-201(d) (General Assembly provided certain protections to rural carriers serving fewer than 100,000 access lines). In fact, since the passage of the 1995 Act, only three carriers have sought and become price regulated.

⁸ Tenn. Code Ann. § 65-4-207(c)(8)(i).

⁹ The Hearing Officer notes that Tenn. Code Ann. § 65-4-101(d) provides that “‘Incumbent local exchange telephone company’ means a public utility offering and providing basic local exchange telephone service as defined by § 65-5-208 pursuant to tariffs approved by the commission prior to June 6, 1995.” All such public utilities prior to June 6, 1995 were rate-of-return regulated, as the option for price regulation did not yet exist. Consequently, the reference to “incumbent local exchange telephone companies in Tenn. Code Ann. § 65-5-207 necessarily referred only to rate-of-return regulated companies on the date the statute became effective.

¹⁰ Both of these rights may be implicated in instances where a carrier’s traditional universal service subsidies are threatened by revenue eroding forces.

Such a conclusion is particularly well-grounded since the 1995 Act mandates that if the Authority establishes an alternative universal service support mechanism, all telecommunications service providers must participate in it; the 1995 Act, however, does not mandate price regulation. The absence of such a mandate demonstrates that universal service participation is not conditioned on either price regulation or rate-of-return regulation. To the extent that practical difficulties arise in implementing a universal service support mechanism for rate-of-return regulated carriers, it is incumbent upon the Authority to overcome them.

III. COMPETITIVE IMPLICATIONS

Consistent with the State of Tennessee's declaration of telecommunications services policy and federal statutory requirements, the Authority's primary focus is facilitating competition, while at the same time maintaining affordable rates for residential subscribers. As a result of Authority decisions, federal rulings, market opportunities, and scale economies, urban markets have experienced much higher levels of competitive activity than their rural counterparts. Rural telephone markets that typically experience higher than average costs and scale diseconomies are less attractive to new entrants. Consequently, rural carriers have been able to enjoy recapture of the cost of providing residential service from revenue streams that remain substantially undisturbed by the influence of competition. However, to the extent that today's competitive footprint continues to traverse urban business areas and the expected downward pressure on profit margins begins to approach margins that could be realized in higher-cost rural areas, those rural areas will become more attractive targets for competitive

entry.¹¹ Accordingly, without some mechanism to maintain local residential rates at affordable levels, universal service as the State of Tennessee traditionally knows it will be threatened.

IV. CONCLUSION

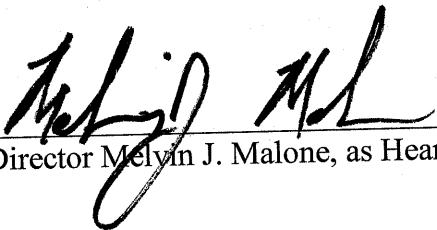
Based on the foregoing analysis, the Hearing Officer concludes that the withdrawal of toll settlement agreements between BellSouth and the Rural Local Exchange Carriers should be considered in the Rural Universal Service proceeding. The Hearing Officer also concludes that the state Universal Service Statute, as enacted, is intended to apply to rate of return regulated rural companies, as such companies are defined under state law.

ACCORDINGLY, IT IS THEREFORE ORDERED THAT:

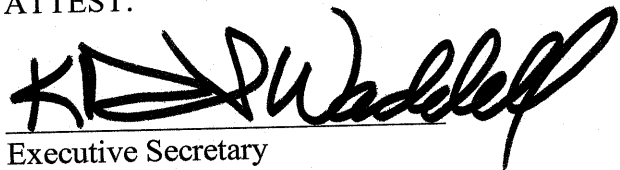
1. The legal issues addressed herein are hereby resolved as set forth in this Initial Order.

¹¹ On April 30, 2002, the Authority granted Level 3 Communications, LLC's application to expand its Certificate of Public Convenience and Necessity to provide telecommunications services throughout Tennessee, including previously protected rural areas, in TRA Docket No. 02-00230.

2. Any party aggrieved by the decision of the Hearing Officer in this matter may file a Petition for Appeal with the Tennessee Regulatory Authority within fifteen (15) days from and after the date of this Initial Order.


Director Melvin J. Malone, as Hearing Officer

ATTEST:


Executive Secretary